Apollo Hospitals Limited

Q2FY15 Results Conference Call Transcript
November 13, 2014

Moderator Ladies and Gentlemen, Good day and welcome to the Apollo Hospitals Q2 FY'15 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Mayank Vaswani of CDR India.

Mayank Vaswani Thank You for joining us on this call to discuss the Financial Results of Apollo Hospitals for Q2 & H1 of FY'15 which were announced yesterday. We have with us today, the senior management team comprising Ms. Suneeta Reddy – our Joint Managing Director; Mr. S.K. Venkataraman – Chief Strategy Officer; and Mr. A. Krishnan – Chief Financial Officer.

Before we begin, I would like to mention that some of the statements made in today's discussions may be forward-looking in nature and may involve risks and uncertainties. For a complete listing of such risks and uncertainties, please refer to our Investor Presentation.

As always, we will start with Ms. Suneeta Reddy who will discuss the "Operating Highlights" for the quarter, following which Mr. Krishnan will discuss the "Operating metrics", "Expansion plans", and "Other Highlights". Documents relating to our financial performance have been shared with all of you earlier and have also been posted on our corporate website.

I now invite Ms. Suneeta Reddy to touch upon the key highlights of our performance.

Suneeta Reddy Thank you for taking out the time to join our call. This quarter, we witnessed good momentum at our new Hospital facilities as well as an uplift in volumes in our existing Hospitals. We have also been able to consolidate our leadership position in the Standalone Pharmacies and further strengthen our presence in the Retail Healthcare business. I am happy to share that we have posted a top line growth of over 18% this quarter, enabled by 12% Y-o-Y growth in revenues from Healthcare Services, 29% Y-o-Y growth in Standalone Pharmacies in Q2 FY'15.

We witnessed a robust revenue growth of 7% over Q1 in our existing Healthcare Services, aided by volume growth. Our Hospitals performance this year has been led predominantly by volume growth of 10%. For e.g., Cardiac Sciences grew by 8%, Orthopedics by 10%, General Surgery by 10%, OBG by 10%, General Medicine by 9%, and Neurology by 11%.

We decided to delay our tariff increases as we commission new beds which otherwise would have helped us realize an even higher revenue growth and would have resulted in better margins. This process of balancing between high yield cases versus volumes between the Chennai units continues and this is also one of the reasons for a relatively lower EBITDA growth in the existing units. New Hospitals have progressively improved performance, driven primarily by our efforts to induct a good set of Super Specialist Doctors and Clinicians in these facilities. As we move forward, we expect growth to further pickup in these facilities on sustained marketing efforts and GP Connect Program.

At our Hospital in Vanagaram Chennai, growth rates registered a Y-o-Y basis that has been noteworthy, with increased occupancy of over 110 beds in Q2 FY'15 compared to 30 beds in Q2 FY'14 last year. The enhancement to our clinical team in key specialties like Cardiac Sciences, Neurosciences, General Medicine, and Orthopedics have aided market penetration and resulted in better patient outflows.

Operations in Jayanagar also witness good traction. The facility has reported an occupancy of 58 beds in Q2 compared to 37 beds in Q2 last year. The operating team at Jayanagar has initiated steps to add other specializations beyond Orthopedics and Neurosciences which have been the anchor of this hospital. The broad-basing of specialties will start showing results in the next quarter. Vanagaram and Jayanagar which were launched in FY'13 reported a positive EBITDA of Rs. 12 million in Q2 this year compared to an EBITDA loss of Rs. 51 million in Q2 last year.

We commissioned our Women and Child facility at Karapakkam in Q2 FY'15. Our FY'14 and FY'15 new facilities in Trichy, Nasik, and Karapakkam are in the initial stages of operations. Revenues from these facilities were 91 million and they registered an EBITDA loss of Rs. 36 million. Our focus over here would be to get all of these also EBITDA-positive at the end of this Fiscal. Growth in our existing Healthcare Services was 8% on a Y-o-Y basis in H1 FY'15 primarily driven by volumes. The Chennai cluster reported a 10% growth in revenues on a Y-o-Y basis in H1 FY'15. The focus on Chennai currently is on further enhancing our clinical differentiation and outcomes through the introduction of newer techniques, advanced technologies such as Robotics as well as Minimally Invasive Procedures and Daycare work. As stated last year, as we continue to rebalance our portfolio of offering and patient segmentation across hospitals, we have decided to defer our tariff hike as we were focused on penetrating the local market and raising our market share. While there has been a slight compression in EBITDA margins, we witnessed increased cost of our medical fraternity also and we are confident that we will regain margins as volumes continue to pick up.

Hyderabad continues to demonstrate an improvement in performance and reported 9% Y-o-Y growth in revenues in H1 FY'15. Occupancy rates were lower consciously because we decided to let go of volumes of lower value cases.. Hence, focused initiative in International markets and the GP Connect Program have helped to increase volume growth and have improved case mix, and this is reflected in our ARPOB. Similarly, growth in existing hospitals at Bhubaneswar, Vizag and Bilaspur remain strong whereas there is a minor dip in volume in centers like Mysore, Madurai, Karur and Karaikudi. On an overall basis, Hospitals outside Chennai and Hyderabad clusters have registered healthy growth in volumes and revenues.

In our Standalone Pharmacy business, revenues were Rs. 437 crore in Q2 FY'15 and both revenues and EBITDA grew 29% on a Y-o-Y basis. The EBITDA margin of the Standalone Pharmacy segment have been steady at 3.3% in Q2 FY'15 compared to the same period last year, despite the DPCO pricing regulations impacting the revenue as well as the margins and higher loyalty costs in our newer stores.

As all of you are aware that in this quarter, we acquired Hyderabad-based pharmacy chain Hetero Med Solutions, which is a natural fit to Apollo because of its significant presence in Andhra Pradesh, Telangana, and Tamil Nadu. This was highly synergistic to our business and will further help strengthen our leadership position in these markets. Hetero Pharmacy will be rechristened as Apollo Pharmacy. We have acquired the business undertaking on slump sale basis for a consideration of Rs.146 crore subject to completing diligence and statutory formalities. Apart from consolidating the back-end operations in these locations, the pharmacy team is looking at levers such as improved stocking, widening of product portfolio including addition to our range of self-branded products, more impactful marketing, and the introduction of value-added services in these stores to get them to more profitable operating margins over the next few quarters.

Coming to our focus on our Retail Health Initiative, in our subsidiary Apollo Health and Lifestyle, there are two developments during this quarter which I would like to share. AHLL has partnered with Pharma Multinational Sanofi to offer an integrated program for diabetes management. India is the diabetes capital of the world and Apollo Sugar Clinics aim to be a one-stop destination for diabetic treatment and will offer a customized regime to better manage diabetes to higher medicine compliance, dietary, exercise schedules, and other lifestyle changes as well as superior management of diabetes-related complications. Through these Clinics, we are going to go beyond what our hospitals can offer. From the current tally of 24 such Clinics, Apollo Sugar Clinic plans to increase its network to 50 Clinics in the first phase.

The second development took place in Apollo Dental Care initiative called WHITE Dental. WHITE Dental has opened its 6th Dental Spa in the country and the first in Pune during this quarter. This is part of its network of 73 Dental Centers of different formats which will be expanded to 100 Centers over the next 24 months.

On the bed expansion front, with the addition of Women and Child facility in Karapakkam, we have successfully commissioned 6 hospitals with a capacity of 800 beds in the last 18 months including Vanagaram, Jayanagar, Trichy, Nasik, and Karapakkam as well as by entering in Indore by acquiring a controlling stake in an existing hospital. The next two quarters will be challenging as a part of our bed expansion is expected to be completed. But both OMR in Chennai and Nellore will be commissioned in the coming quarter, while Malleswaram and Vizag are expected to be commissioned in early FY'16.

Looking forward, we have and will continue to leverage technology to overcome the limitations to traditional modes of delivery of Healthcare Services. We continue to elevate the standards of clinical excellence in patient care. Going ahead, you should expect us to further consolidate our pharmacy leadership and further strengthen our hospital operations as we aim to fast track the time to break even for newer hospitals. We will ensure continued operating progress which should translate into promising revenue and earnings growth.

Now, over to Krishnan – our CFO for details of our financial performance.

A. Krishnan Thank you Ms. Suneeta. On a Y-o-Y basis, revenue growth has sustained an upward trajectory at existing markets especially in our Standalone Pharmacy segment. Whereas also we have contribution to growth from new hospitals, Pharmacies &

Retail Healthcare services added during the period. The good news is that the new hospitals at Jayanagar and Vanagaram have transitioned to positive EBITDA as per plan. As always, I will take you through the key slides, sharing thoughts on the financial performance.

Our Q2 FY'15 standalone revenues grew 18.2% to Rs.1,153 crore from Rs.975 crore in the same period last year. Our standalone EBITDA was at Rs. 173 crore from Rs. 160 crore in Q2 FY'14, a growth of 7.8%. The EBITDA margins were 15% in Q2 this year, a dip of 145 basis points from the EBITDA margins of 16.4% in Q2 FY'14. Change in EBITDA margin is attributable to 3 reasons; – Firstly, the contribution of revenues from the Standalone Pharmacy segment to total revenues have now increased from 35% in Q2 last year to 38% in Q2 of the current year given the growth witnessed in the segment. As Pharmacy EBITDA of 3.3% is lower than Healthcare Services EBITDA, the same reduces the blended reported EBITDA margins.

Secondly, the total EBITDA losses from the new hospitals have been Rs. 2.4 crore in Q2 FY'15. As Ms. Suneeta mentioned in her comment, Vanagaram and Jayanagar have reported a positive EBITDA of Rs. 1.2 crore this quarter which has been offset by the combined EBITDA loss of Rs. 3.6 crore from our facilities at Trichy, Nasik, and Karapakkam.

Thirdly, the EBITDA margin at our existing hospitals have marginally reduced compared to last year due to a combination of cost increases in marketing and increased doctor compensation costs, not completely passed on by tariff hikes. H1 FY'15 standalone revenues grew 18% to Rs. 2,207 crore and the EBITDA was higher by 7.5% at Rs. 329 crore.

Slide 8 of our 'Investor Presentation' provides the split of existing and new units' performance.

Moving to Slide 9, let me take your attention to the ROCE number which has dipped from 17% in H1 FY'14 to 15% in H1 FY'15. ROCE has been impacted by a mix of reduced operating profit margin and an increase in depreciation due to the revised provisions at the New Companies Act. Further, the new hospitals added in FY'13, '14, and '15 now – Vanagaram, Jayanagar, Trichy, Nasik, and Women and Child, Karapakkam – with Rs.477 crore of capital deployment are yet to begin contributing to ROCE.

Details of our consolidated financial performance are presented in Slide 11 and 12. H1 FY'15 consolidated revenues grew 18% to Rs. 2,518 crore. Of this, revenues from existing Healthcare Services business grew 9.3% on a Y-o-Y basis. This includes the strong performance by our joint venture hospitals at Ahmedabad as well as Kolkata. The consolidated financials include a 24.2% growth in revenues by Apollo Munich Health Insurance. Apollo Munich has reported a positive EBITDA of Rs. 4 million in H1 this year compared to a marginal loss in the same period last year. Apollo Health and Lifestyle has delivered 22% growth in revenues from Rs. 34 crore in H1 last year to Rs. 42 crore in H1 current year. However, there has been an EBITDA loss of Rs. 10crore during the period due to higher overhead cost and addition of new clinics and Cradles which are yet to contribute to profitability.

Slide 14 showcases the operational performance of our Hospitals. In Chennai, Inpatient volumes grew by 8% supported by good growth in Vanagaram, which now has an occupancy of over 110 beds. Similarly, Outpatient volumes were higher by 11.4%. We have seen a marginal dip in occupancy at 71% on an expanded bed base of 1,342 Beds in H1 this year as compared to 73% in H1 FY'14. As mentioned by Ms. Suneeta, we are working on rebalancing the cases across the various centers in Chennai. We also have deferred our tariff hikes in Chennai and we would be implementing the same before the end of this fiscal.

Limited bed availability continues to impact the main hospital in Chennai where the team continues to focus on conversion of minor procedures to day care which is reflected in the lower ALOS. The ARPOB at Chennai including Vanagaram grew 4.2% to Rs. 35,000 per day. As discussed earlier, we have made deliberate efforts in the Hyderabad cluster to minimize both low complexity and low paying subsidized cases with a view on enhancing the case mix. The result show that the strategy is paying off with improved revenue realization and profitability. Inpatient volumes increased by 7.4% whereas Inpatient revenues grew 8.6%. Due to the initiatives undertaken, the occupancy continues to remain at 65% in Hyderabad with a noticeable reduction in ALOS as expected. The sustained momentum for the GP Connect Program has resulted in an improvement in OP footfalls by 15.1%. This has helped to push the Hyderabad ARPOB by 11.5% to Rs. 21,965. The hospitals which form part of the others cluster now account for nearly 1,700 Beds, have reported revenue growth of 18.2%, while IP volumes have grown by 9.6%, OP volumes have grown 8.5%, together with a richer case mix, which have translated to growth of 19% in IP revenues and 14% growth in OP revenues. Occupancy is at 65% on an expanded capacity as compared to the previous year. ARPOB in these hospitals was better by 12% at Rs.15,068 when compared to the previous year.

Our joint venture and subsidiary hospitals have shown an encouraging performance as well. OP revenues improved by 12.6% with a 10.4% increase in OP volumes. IP volumes again grew by 6.7%. They were higher by 11.7%, once again reflecting a superior case mix. Occupancy rates were stable at 76% and ARPOB grew by 6% to Rs.26,675. There has been an addition of 100 Beds in this cluster through the acquisition of 51% stake in a running hospital in Indore, now known as Apollo Rajshree Hospital.

Slide 16 covers the batch wise performance of Standalone Pharmacy with sustained growth momentum at 28% increase in H1 revenues on a year-on-year basis. Consequently, EBITDA grew by 20.7% over the previous year. EBITDA margins witnessed a marginal improvement at 3.2% in H1 FY'15 compared to 3.1% in H1 FY'14. Within this the pre-FY2008 batch of stores has hit an EBITDA margin of 5.8%. The revenue per store of the pre-FY2010 batch of stores in H1 FY'15 at 17% and EBITDA per store growth of 27%. Ms. Suneeta cover the acquisition of Hetero Pharmacies, significantly strengthens our Standalone Pharmacy business in the three states of Andhra Pradesh, Telangana, and Tamilnadu. We continue to expand organically and added 53 Stores on a net basis in Q2 FY'15 and 85 Stores in H1 FY'15. As of September 30th, we now have 1,717 Stores. The Hetero acquisition would add around 300 Stores and take the total tally of Stores to over 2,000 stores on a pan India basis subject to due diligence and receipt of statutory approvals.

Slide 18 has details on "Projects and New Capacity". The hospitals in OMR Chennai 170 Beds, Nellore 200 Beds, and North Bangalore 180 Beds are scheduled for launch this year, early next year. The current expansion plan envisages 2,020 Beds up to FY'17 at an investment of Rs. 2,050 crore. Of this, Rs. 1,993 crore on Apollo's share of the CAPEX plan, Rs. 731 crore has already been spent towards these projects. The balance will be funded through a mix of internal accruals and debt. That concludes our presentation. We are now ready to take your questions.

Moderator We have the first question from the line of Neha Manpuria from J.P. Morgan.

Neha Manpuria In the opening comments it was mentioned that we have seen some volume decline in some of the hospitals like Mysore, Karur, etc. A lot of our peers have mentioned that though the Tier-2 might look like an exciting opportunity, but might not be economically viable. Do you think that there is a risk to our 'reach expansion' given what we are seeing in these facilities?

Suneeta Reddy There are two issues. One is what Mr. A. Krishnan mentioned earlier that we were rebalancing our portfolios. As part of that, the paid Government schemes which was done by us earlier is something that we had been very careful with. In fact, we have cut down on those schemes and that has resulted in lower volumes. Having said that, we have now got extremely good doctors in place and are focused on catering to those patients who can actually pay the price of the healthcare that we deliver rather than just focusing blindly on volumes, even though it is in Tier-2 cities. In fact, Karur in the Tier-3 city is a small facility. In the scheme of things, it gives us a deeper understanding of how those markets would be. As you can see from our future growth plans, we are not attempting to do anymore in Tier-3 cities. However, there is a good opportunity to make them EBITDA-positive and it is a long-term strategy.

Neha Manpuria My next question is with respect to the strategy that you have highlighted on Hetero. Do you see any big cut down in the number of stores which currently stand at 320 stores if we were to rationalize it? Should we assume break even over the next few quarters before we move to our average Apollo Pharmacy margins as it was mentioned earlier that it would be turning profitable over the next few quarters? How should we look at the growth plan, over the next 12 to 18 months for the acquired asset?

Obul Reddy Hetero currently operates annual revenues of about Rs.160 crore with negative EBITDA of about 2.5 crore. This includes their backend expenses. Once we start operating those pharmacies after transition into Apollo network, we expect substantial savings on the backend expenses. We also have a very good combination of private label products in our stores which we will be moving into Hetero stores which would improve the margins further. So, given all these, we expect that we would at least to come out of the negative EBITDA and would grow into Apollo level of EBITDA in the next 2 years because they are all in the geographies where we have very well organized backend. On the closure of Pharmacies, we have already studied that we expect about 30 to 40 Pharmacies to be closed. We have factored that into our numbers going forward.

Neha Manpuria It was mentioned earlier that some amount of expansion would also go on the AHLL front like on the Dental and Sugar Clinic. How should we look at CAPEX on these outside the expansion plan that we have? How much CAPEX would this entail?

A. Krishnan We are expanding on the new 3 Cradles in AHLL. The CAPEX expected there is approximately Rs. 50 to Rs. 60 crore on AHLL over the next 6 to 9 months. Regarding Dental, the per dental CAPEX is approximately between Rs. 60 to Rs. 70 lakhs, so that is not a significant number if you consider approximately Rs. 10 crore of CAPEX.

Neha Manpuria I am assuming that Sugar Clinic would also will be small format. So even they would also be in the similar sort of CAPEX requirement?

A. Krishnan Yes. The sugar clinic is a combination of existing and we also have a shop-in-shop model where we already have almost around 24 running clinics in our hospitals as well as the standalone clinics itself. We do not expect that to be having a big impact in CAPEX.

Moderator Our next question is from the line of Girish Bakhru from HSBC Securities.

Girish Bakhru It was mentioned earlier that you have delayed certain tariff hikes. Just wanted to get a sense on how much tariff hikes we expect to take in the next quarter?

A. Krishnan We probably would do around 2.5% to 3% by the end of this quarter.

Girish Bakhru This would be across Chennai or will it be across…?

A. Krishnan Across Chennai.

Girish Bakhru On the overall, you have talked about the Cradles and the growth that you expect from Clinics. When do you expect them starting to contribute in the margin side and when would the break-even happen? Overall, where is the plan, how much Cradles and Clinics that you would probably want to set up at this stage?

Suneeta Reddy The Cradles are looking at the 2-year break-even and Clinics 18 months. Most of these are on lease facilities. So, rental is about 10% of total revenues. We are quite confident because if you look at the growth in Health Checkup and the fact that customers are moving to primary centers for their immediate healthcare needs, we are quite confident that management will be able to ramp this up and shorten the break-even period.

A. Krishnan I think the plan is to get the current network of Cradles to EBITDA break-even early next year.

Girish Bakhru Is there any benchmark in this country for this kind of model?

Suneeta Reddy: By prior experiences we would want to target what became Cloudnine. Cloudnine which was started by Fortis is actually done by Apollo. Maybe La Femme took longer but as you know Cloudnine is a success story. But the business model was conceived and implemented by Apollo Hospitals which is why we thought that we should actually incubate this in our Health and Lifestyle business. We do believe that with the huge demand fall with India's young population and the demand for such services there is potential. As you know we have the youngest population in the world and as Apollo hospitals looks at calibrating quality of case mix, we believe that this is the right experience because the birthing experience is not about illness, it is about the joyous experience of having a child.

Girish Bakhru It is interesting that both you and Fortis are talking about this as an opportunity. On the Oncology side, do you see some kind of similar plan which one could have or would you consider that as a specialty that you want to grow for this model?

A. Krishnan At this point in time, most of our oncology sectors are comprehensive. So, we are looking at Oncology as a comprehensive offering which includes a combination of all the 3, which is Chemo, Radiation as well as Surgical which is what has made us do well so far. As of now we are trying to assess whether we can do similar formats or consider a format for high and premium setting which are similar in places like Bombay and Delhi. We are looking at it, we are looking at the market and study whether we can come into these markets with a premium oncology offering. We are still not yet decided on that, we will come back to you with details once we get it finalized.

Girish Bakhru On the overall margins side, we have seen some pressure over last 3 to 4 quarters. How do you particularly see FY'16 panning out? Do you expect to come back over 16%, some sort of margins?

A. Krishnan Our targets are to retain the current margins because there are at least 3 more hospitals which are going to be coming in the next 6 months. We are going to be starting out OMR in Chennai, we are going to be starting off on Nellore, followed by Vizag as well. So, all of these are going to be new hospitals again. So as an analyst you would understand that blended reported margins are a factor of the existing hospitals, new facilities as well as the Standalone Pharmacies. The Standalone Pharmacies again is growing at 28% - 29%. You will see Hetero also coming into play because Hetero will see some EBITDA by margin losses that to begin with. So, we are trying to retain the same levels of margin in the business, that itself might be a bit difficult because of the new hospitals and Hetero. Otherwise, the existing hospital margins, we expect to increase from the current levels or maintain around the same levels.

S. K. Venkataraman Just to add to what Mr. Krishnan had mentioned earlier that there are clearly 3 reasons why the EBITDA margin is under compression and that is largely an optical thing, This is because as far as individual units are concerned, we are pretty satisfied with the way the margins are panning out.

Moderator Our next question is from the line of Prakash Agarwal from CIMB.

Prakash Agarwal My next question is with respect to the margins. I understand the concern that you talked about in terms of near term i.e these hospitals getting commissioned plus the increase of share by the lower margin Pharmacy business. But in terms of panning out margins, how do you see actually FY'16 and FY'17? What would be the key levers of margin expansion apart from tariff hike that you spoke about in the Chennai cluster?

A. Krishnan As always, the margin expansions in the existing ones have been a combination of ARPOB which is our average revenue per operating bed as well as volumes. It has not just been tariff. It has been ARPOB, which is a combination of both tariff as well as case mix. The focus especially in Chennai as Ms. Suneeta also said is to further enhance the case mix. We are working on increasing the number of transplants that we do here, the number of Robotic procedures that we do, the Minimally Invasive that we do and everything else. Having said that, it is not something which is going to be visible every quarter. You will have to give us some time. You will see that there will be clear benefit which will be visible in the overall Chennai region over the next 2 to 3 quarters and the outpatients will also pick up. The current focus is because we have added 200 new Beds in Vanagaram and another 200 Beds in South Chennai. The number of beds are going to increase substantially. So, focus clearly is now on increasing volumes. After that we will be focusing on seeing how we can further increase our ARPOB and realizations. That is our focus currently. So, I do not think we would want to guide you specifically on the margins as it stands now. You will see us reporting our numbers quarterly which you will see as we report transparently on how each of these specifically shapes up.

Prakash Agarwal I also want to know the expansion that we have already done, in terms of the beds which got operationalized in first and second quarter. Could you give the number of beds that got operationalized in the first and the second quarter of this year?

A. Krishnan We do not have that number directly with us. You can take that offline with Krishna Kumar.

Prakash Agarwal My next question is with respect to the 3 hospitals that you spoke about i.e the OMR, Nellore and the other one. Are these going to be commissioned in the next six months?

A. Krishnan: Correct.

Moderator: Our next question is from the line of Manoj Garg from Bank of America.

Manoj Garg: As you have mentioned that there are going to be some hundred bed additions in Chennai over the next one or two quarters. So starting from FY16 onwards, could we atleast expect the Chennai cluster overall growth going back to high double-digits kind of range?

A. Krishnan: I think, we would not want to guide you towards any numbers which are forward-looking. Our focus is to continue on the current momentum that we have built in. We are first focusing on how we can quickly fill up all the beds that we have commissioned at Vanagaram in particular. OMR is a different market where we have already recruited a good set of doctors and our focus is to see how we can increase our growth in Chennai overall.

Suneeta Reddy: I think that it is also leadership in the specialties that count, because they also add to market share and that will eventually translate into better volumes and better revenues. Let me also add that we are undertaking many efforts to emphasize our clinical differentiation with consumers. This will take time, because we also need to sensitize our referral doctors about the clinical differentiation work that is going on within the system, but we believe that it is more powerful than any marketing tool, while it might take time to actually reflect in both revenues and bottom line it will be the anchor for Apollo.

Manoj Garg: My next question is basically on the "Other Clusters". In the last few quarters we have been growing upward in the 20%-22% kind of range. However comparatively, in this quarter we have probably seen the lower growth of 15%. You have indicated some of the reasons that you are working on which are the case mix improvement and probably giving away lower margin businesses. How do you see the growth going forward in these other clusters per se?

A. Krishnan: This is again forward looking and we would not want to really guide anything towards any growth percentages. But we are very confident of improving our overall momentum as we move forward.

Suneeta Reddy: Also, if you look at the other clusters, it is easy to do in the first five years to keep 20%, going because we have also have beds to do that. As the facility matures then we look at case mix and we also look at the ability to price cleverly. I think that we have been able to do that in spite of competition and we will continue to do so.

Moderator: Our next question is from the line of Chunky Shah from Credit Suisse.

Chunky Shah: My question is with respect to Chennai. Just to dig deeper into the inability to take price increases, I wanted to understand what would be the price differential with a nice competitor, the next hospital that comes there? Also in the first quarter, couple of doctors had left from Apollo. Have the replacements been made of those doctors?

S.K. Venkataraman: To answer the first part of your question, it is not that there is an inability to raise prices We have actually clearly said that, we are deferring price hikes, because of the fact that we are building capacity and we need to go for market penetration, our strategy has always been that whenever we open a new hospital, we would allow the local population to get used to Apollo and get as many footfalls as possible. It is the reason why we consciously deferred our price hike.

As far as your second part of your question is concerned, we clearly are between 10 to 15% over our nearest competition. Also answering your third question regarding what happens to the doctors who have left Apollo and joined other competitors. This is bound to happen. It is not that we did not anticipate this happening. So we have a pipeline of specialists whom we are associating with and those may take one or two quarters before they come on Board. The fact is that some of them have come back and we have a pipeline of good specialists to take care of the volumes.

Chunky Shah: We added beds in Vanagaram, but in the main hospital we are still running at higher utilizations. So what is the reason of not taking a price increase at the main hospital?

S.K. Venkataraman: As we have mentioned in the past few calls also, we are taking a cluster approach as far as managing the facilities are concerned. So some of the patients we actually had to accommodate at Vanagaram and therefore the main hospital did take a dip as far as this is concerned. The lower acuity cases have been shifted there. So there is some rebalancing happening, we expect that to settle down, and therefore we are concentrating on higher acuity cases in the main hospital.

Suneeta Reddy: Also this year we have not done a lot of CGHS patients. So you should keep that in mind that while we have not raised tariff, we have also looked at value addition to the current case mix.

Moderator: Our next question is from the line of Nitin Agarwal from IDFC Securities.

Nitin Agarwal: My question is with respect to the expansion that you have highlighted. How many of these hospitals essentially would be on leased assets?

A. Krishnan: The ones we are adding now, the one in OMR is a leased asset, the one which we are starting thereafter which is Nellore is owned by us, Malleswaram, which is in Bangalore is leased, and Vizag is also owned. So these are the ones which we are seeing, coming up in the next six months**.** All of the leases are long leases as you are aware, none of them would be short leases, all of that is 30 plus 30, most of it is 60-year leases.

Nitin Agarwal: Should that imply relatively lower EBITDA margins in some of these hospitals, longer break even period, if you will, because of the lease commitments?

S.K. Venkataraman: Yes but that will be balanced by a higher ROCE.

Nitin Agarwal: Yes, but from a break even perspective it should get to slightly prolonged break even?

S.K. Venkataraman: That is true, it probably maybe deferred by 6 months to 9 months.

Nitin Agarwal: You had mentioned earlier about the reorienting the case mix in terms of getting away from the CGHS and all of those kinds of patients. But I am just curious, as there is this Government talk about Government massively expanding the healthcare spend in the budget and all of that. So this strategy typically means pretty much that we are not really focusing on that segment, assuming this increase in healthcare spend really comes through from the Government?

Suneeta Reddy: Yes, I think the Government will continue to increase its healthcare spend. It is setting up primary healthcare centers, it is focusing on setting up AIMS like hospitals in some cities and I think that this is really a good move because it takes care of people who need that type of attention and Apollo cannot cater to all of India while we would very much like to do so. We are a corporate entity, we have a responsibility to deliver quality care, and we can only do it in the places that we are committed to and to a relative segment of the population.

Nitin Agarwal: My next question is with respect to the AHLL business. As a business, it contributes a very small proportion to our Healthcare services revenue and frankly even if it grows much faster, it still will not become a relevant material portion of our overall business. So, on a corporate level how do you see this whole business really fitting in with the overall piece?

Suneeta Reddy: I think it is important to understand the direction in which Healthcare is moving. Three years ago when we spent a lot of money on Robotics, everyone said, "Why are you spending this amount of money?" Today, 40% of surgeries in the US are done using Robotics. I think here we have a first mover advantage. In four to five years most of the complicated surgeries will use Robotics and we will probably be the only hospital that will be able to provide this in different specialties. The second thing that we have to look at is that with the introduction of Laparoscopic Surgery, a lot of these procedures will move to Daycare and I think that Apollo has been a pioneer because we have been able to anticipate how healthcare is changing and anticipate what the consumer is expecting. So our idea of incubating Ambulatory Care Centers, the idea of incubating Cradles and anticipating demand for these is, I think extremely relevant for the strategy of Apollo, because it is our intention to continue to incubate these new formats of Healthcare delivery. While it might seem insignificant now, I believe it has great potential for the future.

Nitin Agarwal: But at some stage is there a possibility that this business per se could be a different vertical of its own probably how the Standalone Pharmacy is and you can look at value creation opportunities in that?

Suneeta Reddy: Definitely, I think it could be.

Moderator: Our next question is from the line of Prashant Nair from Citi Group.

Prashant Nair: I have a general question with respect to your Tier-2 City Hospitals. We understand that the ARPOBs would be lower because the price points are lower. I wanted to understand how EBITDA margins in any of these hospitals at "Steady State' would compare with say a similar hospital in a large city?

A. Krishnan: If you look at places like Madurai, Bhubaneshwar and the likes, the EBITDA margins there are similar to the EBITDA margins that we see elsewhere, specifically because the way we manage costs there is also different, as the cost of operations are low, the cost of having clinicians and doctors are different from what we do in the main hospitals, etc.

Moderator: Our next question from the line of Shashikiran Rao from Standard Chartered Securities.

Shashikiran Rao: It was mentioned earlier that you had deferred a price hike in Chennai to gain market traction. My question is more on a conception level and I want to know whether you have seen price sensitivity in terms of gaining market share so that becomes an impediment to increasing or changing prices?

S.K. Venkataraman: Conceptionally I agree with you that there is absolutely no price sensitivity which is a conscious decision taken by us. In fact, we have done it historically in the past whenever we have opened hospitals. This is again to reiterate what I had mentioned earlier that we want the local population to get the touch and feel of Apollo when they come in and we do not want them to get intimated because of the perception of being costly. So once we get the volumes automatically, the customer is willing to pay a higher price because of the premium and the value with the number of services.

Shashikiran Rao: How does the cluster approach to pricing work in that sense? Would you increase the prices across all the hospitals in the cluster in one go or would you be open to increasing, having differential pricing for different hospitals in the same cluster?

Suneeta Reddy: No, I think that we are really sensitive to what a hospital can take. CEOs of each unit do look at it and report back to us. Having said that, in new hospitals we do focus on volumes and filling up the beds. Today Vanagaram's occupancy is close to 70%, which I think is a milestone. Having said that, I think they are ready for a price increase and this is the way we operate. Once we have done that, then we start focusing on case mix.

Moderator: Our next question is from the line of Praveen Sahay from Batlivala & Karani Securities.

Praveen Sahay: The outpatient volumes for Hyderabad, is 15% up. But the revenue from them is just around 10 to 11%. So what is reason for this? Is it lower value cases and increased quite frequently or something else?

A. Krishnan: If you look at even last quarter, the similar trend continues and it is actually better in Q2. While in the Outpatient there have been a good increase in overall footfalls and there are people who are coming in for consults and second consults, etc., there are still being some details in the investigations and the diagnostics that we are looking at today to see how we can increase it. So we are cognizant of where the footfalls have gone up, but it has still not increased the overall Outpatient revenues to the same extent.

Praveen Sahay: What is the main reason for this? Ma'am has already guided the lower potential level. Could you please mention it again?

A. Krishnan: ALOS or Hyderabad cluster has significantly come down. If you notice that it has come down from 4.54 to 4.13, which is a signification reduction in the average length of stay which we have achieved. This actually seemingly brings out the occupancy but helps the ARPOB. The focus are clearly been on ARPOB, focus has been on weeding out the cases which have not been yielding high realization, etc., for us which is what has been the strategy there. Hyderabad has actually contributed well to the overall EBITDA margins as well consequently.

Praveen Sahay: On the Jayanagar and Vanagaram, we had increase in ARPOB like 58% for Vanagaram, Jayanagar 50%. So how is then ARPOB level out there?

A. Krishnan: ARPOB in Vanagaram is quite good as we have started with an ARPOB of almost around north of Rs. 20,000 over there. Jayanagar being a Super Specialty Hospital, we have Orthopedics and Neuro which are the anchor specialties there, the ARPOB again there is good.

Praveen Sahay: My next question is with respect to the Pharmacy business. In the first half we have added somewhere around 85 Stores on net in places. But we are seeing a correction there in EBIT margin. So what is the strategy for an organic growth here?

Obul Reddy: We have some impact because of DPCO in H1 current year and we will be compensating rest with the volume growth and Private Label products going up in the product mix. If you look at our pre-2010 cluster, same-store sales is around 13%, which is very healthy.

Praveen Sahay: So would we be going forward in the similar way similarly the way we had quite aggressively added net 85 stores for the first half?

S.K. Venkataraman: We will be opening more or less on the same lines in H2 as well.

Moderator: The next question is from the line of Anubhav Aggarwal from Credit Suisse.

Anubhav Aggarwal: My question is on the new acquisition that you have done on the Hetero Pharmacy. I wanted to understand that in two years down the line or when the margins become equal to Apollo Pharmacy level, what kind of return you are investing? So once you invest Rs.146 crore and sales level Rs.160 crore today, even if it reaches 5-6% margin, we are not going to get 7-8% return here. When do you think you can get 15% return? I also have a question with respect to the capital allocation policy of Apollo. Between Pharmacy and Hospital, I always thought that Hospital makes you more money. Why this acquisition of Hetero? Do you plan to increase more footprints in Pharmacy in future as well at the cost of let us say resources for a Hospital business?

Suneeta Reddy: I think it goes back to our strategy. With regard to Hetero and margin, we truly believe that over the next 18 months we should be able to move EBITDA margins to 6%. If you look at the nature of any retail business, I think if you see EBITDA margins at 10%, you are looking at an ROCE of above 14-15%. It is really our focus on improving the ROCE that we are looking at, at this point. Also, capital allocation of Rs.140 crore will enable us to actually dominate the space. Domination in retail is a very important strategy that we need to play because there are others who are actually eating away our margins with their pricing policies. Third, it gives us the ability to actually leverage a Private Label where the margins are very high. It also changes the store composition where we have larger format stores, and this is really key, because all of the Hetero Stores are actually double the size that the Apollo average store and this gives us the ability to add some FMCG products which will give us higher margins. So I think this is the rationale behind it. "Will we do it again?" My answer to this question would be that I do not anticipate allocating Rs.140 crore of capital in one shot to the Pharmacy business. I think we are a healthcare provider, we will see good margins in the Hospital delivery space. But, it is again a business that we are incubating and you must look at it from that perspective that we will continue to add value in that space.

Anubhav Aggarwal: So basically in 2-2.5 years, you think that ROCE of Hetero Pharmacy can go up to about 14%?

A. Krishnan: It would not get to the 14% level in the next 2-2.5 years. We are focusing on getting into the 15% level in the next few years.

Anubhav Aggarwal: What kind of sales level you are talking about? Is it the Rs. 160 crore sales number doubling from here or Rs. 250 crore number or something?

S.K. Venkataraman: About 3 years we expect them to double.

Moderator: The next question is from the line of Lalit Kumar from Nomura Securities.

Lalit Kumar: My question is related to Sugar Clinic. The number of Sugar Clinic currently stands at 24. Where do you see the number in 3-5 years down the line? Also, how much revenue it can generate versus what we are generating currently, what our competitors are generating currently?

A. Krishnan: At this point in time the Sugar Clinics are generating approximately Rs. 18 crore of revenue and they are part of our existing hospitals and clinics. Once we spin that out you will see that as a separate vertical and we will begin reporting those numbers maybe in a year or so. The first way we plan to increase the number of clinics from 24 to 50. Thereafter our plan is to take it to 100 clinics over the next 18-24 months. Importantly, we look at it as a combination of two things; one is Advanced Diabetes Management Center which are larger centers which have full medical base and takes care of the diabetes management holistically end-to-end and then supported that by Sugar Clinics which is going to be coming in Hospitals as well as Clinics and Standalone. We will have to look at the plans as we move forward because today as we look at it we think it is a business which is important for India because as we have seen in other developed countries, diabetes management is really taking a lot of center stage in some of the other developed countries and India in particular we are seeing a lot of prevalence of diabetes. We think the holistic management including Lifestyle, Wellness and Diagnostics, this is something which will start showing up well in the overall Sugar business. We do not have an immediate number for the same.

Lalit Kumar: In case if you can share some of our competitors in this space, our Life Span Clinic or other clinic. What kind of margin revenue they are generating per clinic. They have a standalone diabetic management centers, right?

A. Krishnan: They are small now and so I would not have visibility on them yet because none of them are listed and we do not have the numbers directly. We now have a separate team handling Sugar Clinics with separate CEO, etc., but clearly the focus is to take the revenues with the health check and everything else. We clearly think that per clinic we can go to Rs.2-4 crore per year.

Moderator: The next question is from the line of Abhishek Sharma from India Infoline.

Abhishek Sharma: Would it be possible for you to share some details on the Nova Medical acquisition? What is the strategic rationale and any broad financials that you can share?

A. Krishnan: It is not done yet. As it stands now, we are still examining the asset, we still have not yet completed the whole acquisition, etc. The media has carried it at a premature level.

Abhishek Sharma: So you anticipate it closing in near future? Do you have a timeline?

S.K. Venkataraman: We have no comments on this matter at the moment.

Suneeta Reddy: I think it is difficult for us to comment.

Moderator: The next question is from the line of Ravi Dodhia from CRISIL.

Ravi Dodhia: I would like to understand about the strategic partner that you are looking for the Pharmacy business? Also, now with Hetero coming in, you currently have around 2,000 stores. When would this materialize? Any thought process on the same?

Suneeta Reddy: I think the rationale behind the Hetero acquisition has been explained earlier by us. As times goes on, our next play on Private Label, inventory management, handling stock, reducing the overheads that Hetero has and the whole strategy on using cost will actually just improve valuation. Right now we have no partner in mind. We have many requests for partnerships, as well as investors. While we are examining this, let me say that there is no specific entity that we can name at this time.

Ravi Dodhia: There was news with respect to a few companies eyeing Seven Hills Hospital in Mumbai. So is Apollo Hospitals looking at that opportunity?

S. K. Venkataraman: We actually cannot react to any speculative information.

Ravi Dodhia: If we look at the CAPEX per store for the Pharmacy business, it has increased to 2.7 million per store compared to 2.2 million earlier. So is it that in the last quarter the number of stores which you have added are large format stores?

Obul Reddy: We are now consistently moving into large format stores and the proposed new stores addition is the reason for the increase in the CAPEX.

Ravi Dodhia: With respect to the mature pharmacy stores, the EBITDA margin is still in the range of 5.7%-5.8% and that has remained at that level since past 3-4 quarters. So do you see it expanding to 6-6.5%?

Obul Reddy: As explained, it should be in the range of 6-6.5%. DPCO impact is about 30 basis points which we will be recovering through volume growth and we expect them to move to 6-6.5% in the next 2-3 quarters.

Moderator: We will take the last question from the line of Pritesh Chheda from Emkay Global.

Pritesh Chheda: In your experience, what is the payback period on assets which are opened up in Tier-1 and Tier-2 towns if they are owned assets?

A. Krishnan: Approximately 6-7 years.

Pritesh Chheda: This is the cash payback, sir?

A. Krishnan: Which is correct.

Pritesh Chheda: Even if it is Tier-2, the number stays 6-7 years?

A. Krishnan: That is correct.

Moderator: I now hand the floor back to the management for any closing comments.

Suneeta Reddy: As I conclude, I would like to share with you all the Department of Posts has recently released the stamp commemorating the 15^{th} Anniversary of our First Ever Transplant in India which was a liver transplant on a 2-year old patient undertaken in New Delhi. It is a rare honor and a small step in a journey that we began 30-years ago as a pioneer in the tertiary care space. Today, we continue to be pioneer because of our commitment to clinical excellence, quality, the ability to absorb new technology, treatment protocols and new format. More importantly, our capacity addition indicates a deep understanding of both the market and the consumer. We are confident that Apollo will continue to remain priceless for both our patients and our investors. Thank you, all for joining us on this call.

Moderator: Thank you. On behalf of Apollo Hospitals that concludes this conference.